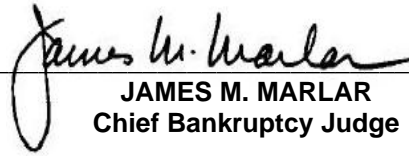


SIGNED.



Dated: February 23, 2010

  
JAMES M. MARLAR  
Chief Bankruptcy Judge

IN THE UNITED STATES BANKRUPTCY COURT  
FOR THE DISTRICT OF ARIZONA

In re:	)	Chapter 7
JOHN A. CHAVEZ and PAULA F.	)	No. 0:08-bk-18092-JMM
CHAVEZ,	)	Adversary No. 0:09-ap-00128-JMM
_____ Debtors.	)	
BRADEN TRUST and BRADEN FAMILY	)	<b>MEMORANDUM DECISION RE:</b>
PARTNERSHIP dba Texas Hill Farms,	)	<b>MOTIONS FOR SUMMARY JUDGMENT</b>
Plaintiffs,	)	
vs.	)	
JOHN A. CHAVEZ and PAULA F.	)	
CHAVEZ,	)	
_____ Defendants.	)	

Before the court is the Defendants' motion for summary judgment (DN 18), as well as the Plaintiffs' motion for summary judgment (DN 20). The motions were heard on January 29, 2010. The court has now considered the contents of the adversary file, as well as the law and rules in favor of the Defendants. As the relevant facts are not in dispute, the court may rule on the motions without need for a trial. FED. R. BANKR. P. 7056.

1 **BACKGROUND**

2  
3 At a period prior to the bankruptcy filing, Defendant John Chavez was an employee  
4 of the Plaintiffs. As an employee, Mr. Chavez rose to the level of general manager. He was never  
5 an officer, member, partner or principal in any Plaintiff entity. During the course of the employment  
6 relationship, Mr. Chavez misappropriated money or property belonging to Plaintiffs.

7 After terminating Mr. Chavez, the Plaintiffs commenced a state court action, in which  
8 Plaintiffs sought a money judgment. An arbitration occurred, the parties presented their evidence,  
9 and the arbitration panel ruled in favor of the Plaintiffs and against the Chavez'. Before the award  
10 could be confirmed by the Superior Court, however, Mr. and Mrs. Chavez filed a Chapter 7  
11 bankruptcy proceeding.

12 The arbitration award was in the sum of \$466,865. (Ex. A to Plaintiffs' Statement of  
13 Facts.)

14  
15 **THE BANKRUPTCY, AND NON-DISCHARGEABILITY ALLEGATIONS**

16  
17 The Defendants filed their bankruptcy case on December 15, 2008. Within the  
18 appropriate time period, the Plaintiffs commenced this non-dischargeability action.

19 Plaintiffs' complaint alleges a single cause of action, that of breach of fiduciary duty--  
20 specifically a defalcation or misappropriation of property-- which is actionable under a bankruptcy  
21 statute, 11 U.S.C. § 523(a)(4).

22 Defendant John Chavez was employed by Plaintiffs pursuant to an employment  
23 contract. (Ex. B to Plaintiffs' Separate Statement of Facts.) This contract provided that it was  
24 governed by the laws of the State of Arizona. (Ex. B, para. 15.) The contract also provided that Mr.  
25 Chavez was to "well and faithfully" serve Plaintiffs, in his capacity as "employee" and their capacity  
26 as "employer." (Ex. B, para. 3.A.)  
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Motions for summary judgment are governed by Rule 56(c) of the Federal Rules of Civil Procedure, which is made applicable to bankruptcy proceedings by Federal Rule of Bankruptcy Procedure 7056. Under Rule 56, the Court should grant summary judgment "if the pleadings, the discovery and disclosure materials on file, and any affidavits show that there is no genuine issue as to any material fact and that the movant is entitled to judgment as a matter of law." FED R CIV. P. 56(c)(2).

Section 523(a)(4) excepts from discharge a debt "for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny" <sup>1</sup> A debt is non-dischargeable under § 523(a)(4) where "1) an express trust existed, 2) the debt was caused by fraud or defalcation, and 3) the debtor acted as a fiduciary to the creditor at the time the debt was created." *In re Niles*, 106 F.3d 1456, 1459 (9th Cir. 1997).

<sup>1</sup> The complaint does not specifically allege embezzlement or larceny.

1 The meaning of "fiduciary" in bankruptcy is a matter of federal law. *In re Hemmeter*,  
2 242 F.3d 1186, 1189 (9th Cir. 2001). "Fiduciary" in the bankruptcy discharge context includes  
3 relationships involving express trusts, but excludes trusts *ex maleficio*, i.e., trusts that arise by  
4 operation of law upon commission of a wrongful act. *Id.* (citing *Davis v. Aetna Acceptance Co.*, 293  
5 U.S. 328, 333, 55 S.Ct. 151, 79 L.Ed. 393 (1934)). In other words, debtor must have been a "trustee  
6 before the wrongdoing and without reference to it." *Lewis*, 97 F.3d at 1185 (citing *Davis*, 393 U.S.  
7 at 333, 55 S.Ct. at 154); *Ragsdale v. Haller*, 780 F.2d 794, 796 (9th Cir. 1986). While the  
8 definition includes statutory trusts which meet certain requirements, it does not include constructive,  
9 resulting and implied trusts. *Hemmeter*, 242 F.3d at 1189-90 (citing *In re Pedrazzini*, 644 F.2d 756,  
10 758-59 (9th Cir. 1981)).

11 Accordingly, the Ninth Circuit has "adopted a narrow definition of 'fiduciary' for  
12 purposes of § 523(a)(4)." *In re Cantrell*, 329 F.3d 1119, 1125 (9th Cir. 2003). The "broad general  
13 definition of fiduciary—a relationship involving confidence, trust and good faith—is inapplicable in  
14 the dischargeability context." *In re Short*, 818 F.2d 693, 695 (9th Cir. 1987); *Lewis*, 97 F.3d at 1185;  
15 *In re Evans*, 161 B.R. 474, 477 (9th Cir. BAP 1993). "This circuit requires that for the purposes of  
16 § 523(a)(4) the debtor must have been *a trustee in the strict or narrow sense* through an expressed  
17 or technical trust." *Banks v. Gill Distrib. Centers, Inc.*, 263 F.3d 862, 871 (9th Cir. 2001) (finding  
18 that attorney was a fiduciary to client in relation to client trust account holding settlement funds)  
19 (emphasis supplied); *Lewis*, 97 F.3d at 1185.

20 An express trust has been described as follows.

21 The general characteristics of an express trust are 1) sufficient words  
22 to create a trust; 2) a definite subject; and 3) a certain and ascertained  
23 object or res. *The intent to create a trust relationship rather than a*  
24 *contractual relationship is the key element in determining the existence*  
*of an express trust.*

25 *Pedrazzini*, 644 F.2d at 758 n.2 (quoting *In re Thornton*, 544 F.2d 1005, 1007 (9th Cir. 1976))  
26 (emphasis supplied) .

1 State law is to be consulted "to ascertain whether the requisite trust relationship  
2 exists." *Cantrell*, 329 F.3d at 1125 (citing *Lewis*, 97 F.3d at 1185, and *Ragsdale*, 780 F.2d at  
3 796).

4 Both statutory and case law can give rise to a trust within the meaning of § 523(a)(4).  
5 *In re Stanifer*, 236 B.R. 709, 715 (9th Cir. BAP 1999) (examining fiduciary duty imposed on  
6 partners and holding that trust existed between spouses and their obligations to account for  
7 community property). For example, Ninth Circuit courts have applied a combined statutory and  
8 case-law analysis to determine that licensed real estate brokers as well as securities brokers, in  
9 California, are fiduciaries for purposes of § 523(a)(4). *See Niles*, 106 F.3d at 1459 ); *In re Woosley*,  
10 117 B.R. 524, 529 (9th Cir. BAP 1990); *In re Scheuer*, 125 B.R. 584, 592 (Bankr. C.D.Cal. 1991).  
11 The Ninth Circuit Court of Appeals, in *Lewis*, consulted Arizona case law to determine that  
12 individual partners stood in a fiduciary relationship with one another. 97 F.3d at 1186.

13 In Arizona, corporate directors and officers and shareholders that have the ability to  
14 control a corporation owe a fiduciary duty to the corporation and other shareholders. *F.D.I.C. v.*  
15 *Jackson*, 133 F.3d 694, 703 (9th Cir 1998) (citing cases); *Mims v. Valley Nat'l Bank*, 14 Ariz. App.  
16 190, 192, 481 P.2d 876, 878 (App. 1971); *Kadish v. Phx.-Scotts. Sports Co.*, 11 Ariz. App. 575, 578,  
17 466 P.2d 794, 798 (App. 1970). Moreover, this fiduciary status meets the requirements of federal  
18 law. *Jackson*, 133 F.3d at 703; *Kadish*, 11 Ariz. App. at 579, 466 P.2d at 798; *In re Sullivan*, 217  
19 B.R. 670, 675-76 (Bankr. D. Mass. 1998) (applying Arizona law, citing cases, and holding that "[i]n  
20 Arizona, it is well established that a director or officer of a corporation owes a fiduciary duty to the  
21 corporation," and such duties satisfy the element of fiduciary relationship for purposes of  
22 § 523(a)(4)). Business partners also owe a fiduciary duty to one another that is actionable under §  
23 523(a)(4). *Lewis*, 97 F.3d at 1186.

24 Arizona case law also applies the Restatements of law, which impose general duties  
25 of loyalty upon agents toward their principals. *See, e.g., McCallister Co. v. Kastella*, 170 Ariz. 455,  
26 825 P.2d 980 (App. 1992); *Home Builders Ass'n of Cent. Az. v. City of Goodyear*, 223 Ariz. 193,  
27 221 P.3d 384 (App. 2009); RESTATEMENT (SECOND) OF AGENCY § 387 (1958); RESTATEMENT  
28 (THIRD) OF AGENCY §§ 1.01, 8.01 *et seq.* (2006).

1 Plaintiffs cite to the body of Arizona case law which imposes a fiduciary duty on a  
2 general manager of a company. *See Mohave Elec. Co-op., Inc. v. Byers*, 189 Ariz. 292, 307, 942  
3 P.2d 451, 466 (App. 1997) (finding that the assistant general manager, who supervised the  
4 accounting and finance departments, breached her “independent fiduciary duty” to her employer as  
5 well as her employment contract). The court in *Mohave Electric* further held that the general  
6 manager and assistant general manager owed their employer “fiduciary duties including honesty,  
7 loyalty, fair play, fair dealing and good faith.” *Id.* (citing *Kastella*, 170 Ariz. at 457, 825 P.2d at  
8 982). *See also Fernandez v. Garza*, 88 Ariz. 214, 220, 354 P.2d 260, 264 (1960) (“a managing  
9 partner occupies a position analogous to that of trustee . . .”) (emphasis added).<sup>2</sup> Plaintiffs also cite  
10 cases, from other circuits, where corporate presidents or general managers were determined to be  
11 fiduciaries under federal law. *See, e.g., In re Cummins*, 166 B.R. 338, 354 (Bankr. W.D. Ark.  
12 1994).

13 However, no Arizona case, nor Ninth Circuit case applying Arizona law, has been  
14 cited or found which has the identical factual situation for the precise issue here: whether an  
15 employer-employee relationship, even when the employee is also the general manager, creates a  
16 fiduciary relationship that is actionable under § 523(a)(4).

17 Defendants maintain that a principal-agent relationship is a contractual relationship  
18 and does not rise to the level of an express trust. They argue that the Ninth Circuit has rejected  
19 contractual relationships as express trusts in *Pedrazzini*. There, a general contractor was hired by  
20 a homeowner to build a swimming pool. He diverted some of the funds intended for completion of  
21 the project. In the contractor’s subsequent bankruptcy case, the homeowner sued for non-  
22 dischargeability of the debt under § 523(a)(4). The Ninth Circuit affirmed the bankruptcy court’s  
23 determination that the contractor was not a fiduciary under federal law. *Id.*, 644 F.2d at 758-59.

24 *Pedrazzini* is consistent with federal law, applied in other cases involving strictly  
25 contractual relationships, where the “trust” actually arose upon the wrongdoing. *See Chapman v.*  
26

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27 <sup>2</sup> In *Garza*, the Arizona Supreme Court found that partners have a duty to account  
28 for proceeds of partnership property. 88 Ariz. at 219, 354 P.2d at 264. However, in our case, the  
arbitrator denied a claim for an accounting. *See Arbitration Award* ¶ 15. It is unclear whether  
there is any significance to that factual distinction.

1 *Forsyth*, 43 U.S. (2 How.) 202, 11 L.Ed. 236 (1844) (debtor-creditor relationship between purchaser  
2 and seller of 150 bales of cotton); *Davis v. Aetna Acceptance Co.*, 293 U.S. 328, 55 S.Ct. 151, 79  
3 L.Ed. 393 (1934) (debtor-creditor relationship between a car dealer and finance company); *Matter*  
4 *of Angelle*, 610 F.2d 1335 (5th Cir.1980) (debtor-creditor relationship between home contractor and  
5 home purchaser); *In re Heilman*, 241 B.R. 137 (Bankr. D. Md. 1999) (same).

6 Courts in other jurisdictions have found that "[f]iduciary capacity within the meaning  
7 of section 523(a)(4) may be found in an employment relationship." *In re Golden*, 54 B.R. 957, 964  
8 (Bankr. D. Mass. 1985). In *Golden*, the court held that a department manager who obtained  
9 unauthorized kickbacks was the fiduciary of his employer where the manager "occupied a position  
10 of trust, was in control of corporate property, and was given responsibility for maintenance and  
11 disbursement of corporate funds to vendors." *Id.*; see also *Gen. Ins. Co. of America v. Klein*, 517  
12 S.W.2d 726, 729 (Mo. App. 1974); *In re Entrekin*, 40 B.R. 435 (Bankr. S.D.Fla. 1984) (debtors  
13 employed as computer programmers who controlled disbursement of their employer's cash flow  
14 were found to be fiduciaries under § 523(a)(4)). Some courts have opined, generally, that "an  
15 employee can be found to have acted in a fiduciary capacity under § 523(a)(4) if that employee  
16 occupies a position of trust within the scope of his or her employment," *Sullivan*, 217 B.R. at 676  
17 (citing *Golden* and finding that a factual issue existed as to fiduciary status of Debtor-wife), and that  
18 the fiduciary element may exist in situations involving a "difference in knowledge or power between  
19 fiduciary and principal which . . . gives the former a position of ascendancy over the latter," such  
20 as lawyer-client, or managing partner and limited partner. *Matter of Marchiando*, 13 F.3d 1111,  
21 1116 (7th Cir. 1994)

22 Overall, however, courts continue to follow the narrow approach and require a  
23 definable trust res. See, e.g., *In re Garver*, 116 F.3d 176, 180 (6th Cir. 1997) ("[T]he defalcation  
24 provision of § 523(a)(4) is limited to only those situations involving an express or technical trust  
25 relationship arising from placement of a specific res in the hands of the debtor."); *In re Bigelow*, 271  
26 B.R. 178, 187 (9th Cir. BAP 2001) ("[A]ttorney-client relationship may rise to the level of a  
27 fiduciary relationship for purposes of § 523(a)(4) if there are client trust funds involved") (emphasis  
28 added); *In re Sparrow*, 306 B.R. 812 (Bankr. E.D. Va. 2003) (holding that, while Virginia law

1 imposed a duty of loyalty on the debtor/employee as agent, there was no fiduciary relationship  
2 within the meaning of § 523(a)(4), which required the existence of an express or technical trust);  
3 *In re Marderosian*, 186 B.R. 341 (Bankr. D. R.I. 1995) (insurance agent who issued "clean" title  
4 insurance policies to purchasers of property upon which there were preexisting mortgages, and  
5 misappropriated funds *held in escrow accounts* entrusted to him for purposes of paying off existing  
6 mortgages, was a fiduciary under § 523(a)(4)); *In re Trovato*, 145 B.R. 575, 580 (Bankr. N. D. Ill.  
7 1991) ("Agency is not the kind of 'fiduciary capacity' that gives rise to nondischargeability under  
8 Section 523(a)(4)."); *cf. Marchiando*, 13 F.3d at 1116 (debt arising from store owner's failure, as  
9 a lottery ticket agent, to remit ticket sale proceeds to the State was dischargeable).

10           Plaintiffs further cite to *Stanifer* for the proposition that express agreements between  
11 parties, such as the employment contract in this case, can create the requisite fiduciary relationship.  
12 The Ninth Circuit Bankruptcy Appellate Panel, in *Stanifer*, reiterated the narrow definition of a  
13 fiduciary under Ninth Circuit law as well as the standard characteristics of an express trust, which  
14 it stated "is created by an agreement between two parties to impose a trust relationship." 236 B.R.  
15 at 714. The BAP did not abrogate the requirements that an express trust contain "(1) sufficient  
16 words to create a trust; (2) a definite subject; and (3) a certain and ascertained object or res." *Id.*  
17 Nonetheless, that case addressed a novel factual situation where a former wife sought to determine  
18 that the former husband's debt for failure to pay her a portion of his community property pension  
19 benefits was non-dischargeable. The BAP concluded that California statutory and case law  
20 established a sufficient "trust" and fiduciary relationship between spouses in regard to their  
21 community property. *Id.* at 719. The Court is not persuaded that *Stanifer* would support the same  
22 finding in the case of an employee-employer relationship.

23           The foregoing discussion illustrates just how flexible the term "while acting in a  
24 fiduciary capacity" has become across the circuits. But, in the end, this court must of course follow  
25 the path laid out by the Ninth Circuit. And that path is a conservative one, requiring some sort of  
26 actual trust relationship, not just a generalized duty of loyalty. Even the Arizona cases recognize  
27 distinctions--not appearing in this case--which carry more responsibility than that of an employee  
28 to his/her employee.

1 The issue is one of first impression for this court, and perhaps one for the reported  
2 cases in the Circuit. In its review of the cases, this court must conclude that 11 U.S.C. § 523(a)(4)  
3 would not, under current Ninth Circuit law or Arizona law, rise to the level--for a bankruptcy non-  
4 dischargeability action--of including an employee-employer relationship.

5 Therefore, Defendants' motion for summary judgment on that issue will be granted.

## 6 7 **2. Section 523(a)(6)**

8  
9 Section 523(a)(6) excepts from discharge a debt "for willful and malicious injury by  
10 the debtor to another entity or to the property of another entity." This court looks to state law to  
11 determine whether an act falls within the tort of conversion, *In re Jercich*, 238 F.3d 1202, 1206 and  
12 n.16 (9th Cir. 2001). To prove conversion in Arizona, a party must show "an act of wrongful  
13 dominion or control over personal property in denial of or inconsistent with the rights of another."  
14 *Case Corp. v. Gehrke*, 208 Ariz. 140, 143, ¶11, 91 P.3d 362, 365 (App.2004) (quoting *Sears*  
15 *Consumer Fin. Corp. v. Thunderbird Prods.*, 166 Ariz. 333, 335, 802 P.2d 1032, 1034 (App.1990)).

16 However, a technical conversion under state law is not necessarily a "willful and  
17 malicious injury." *In re Peklar*, 260 F.3d 1035, 1039 (9th Cir. 2001). Federal law requires more.  
18 In *Kawaauhau v. Geiger*, 523 U.S. 57, 118 S.Ct. 974, 140 L.Ed.2d 90 (1998), the Supreme Court  
19 held that "[t]he word 'willful' in (a)(6) modifies the word 'injury,' indicating that nondischargeability  
20 takes a deliberate or intentional *injury*, not merely a deliberate and intentional *act* that leads to  
21 injury." *Id.*, 523 U.S. at 61, 118 S.Ct. at 977.

22 The difficulty with attempting to apply this section of the Bankruptcy Code to this  
23 case is that it was never pled as a cause of action. The Plaintiffs' entire case, in bankruptcy court,  
24 is based on a theory of fiduciary capacity under 11 U.S.C. § 523(a)(4).

25 Even though the court, in its ruling on Defendants' motion to dismiss, mentioned  
26 § 523(a)(6) as being, possibly, included within the four corners of the complaint, closer inspection  
27 now reveals that such theory of liability was not actually articulated. In a Rule 12(b)(6) motion, the  
28 only legal concern is to ascertain whether a complaint, on its face, states a claim. The court's

1 passing comment in its order (DN 9), was not a ruling on whether that count was actually contained  
2 in the complaint. The focus, at a Rule 12(b)(6) hearing, is different than what is required in  
3 resolving a motion for summary judgment.

4 Even so, Plaintiffs never moved to amend their complaint to include a willful and  
5 malicious injury allegation under § 523(a)(6), and thus, the court must now find that they cast their  
6 net solely on § 523(a)(4) grounds.

7  
8 **RULING**

9  
10 For all of the reasons set forth above, the court will enter an order granting Defendants'  
11 motion for summary judgment.

12 It is also appropriate, at this stage, to address and dispose of Defendants'  
13 "counterclaim." Defendants have no legal standing, in a Chapter 7 proceeding, to seek  
14 compensatory damages in response to an action for non-dischargeability. This is because, in a  
15 Chapter 7 case, the representative of the "estate" is the Trustee. 11 U.S.C. § 323. The Defendants  
16 no longer have an independent right to seek damages. They have surrendered those rights to the  
17 Trustee.

18 Therefore, the counterclaim will be dismissed.

19 This case has now been fully resolved, as to all issues and all parties. A separate final  
20 judgment will be entered. FED. R. BANKR. P. 9021.

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22 DATED AND SIGNED ABOVE.  
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1 COPIES to be sent by the Bankruptcy Notification  
Center ("BNC") to the following:

2 Steven M. Cox, Attorneys for Debtors/Defendants

3 Don B. Engler, Attorney for Debtors/Defendants

4 A. James Clark, Attorney for Plaintiffs

5 Office of the United States Trustee

6 Deborah Bryant, Trustee